VZCZCXRO3508
RR RUEHBC RUEHDE RUEHIHL RUEHKUK
DE RUEHGB #3397/01 2981446
ZNY CCCCC ZZH
R 241446Z OCT 08
FM AMEMBASSY BAGHDAD
TO RUEHC/SECSTATE WASHDC 0069
INFO RUCNRAQ/IRAQ COLLECTIVE
RHEBAAA/USDOE WASHDC

C O N F I D E N T I A L SECTION 01 OF 04 BAGHDAD 003397

SIPDIS

DOE FOR PERSON

E.O. 12958: DECL: 10/24/2018
TAGS: EPET ENRG EINV IZ
SUBJECT: IRAQ OIL MINISTER LAUNCHES FIRST LICENSING ROUND

REF: A. BAGHDAD 3332
¶B. BAGHDAD 3241
¶C. BAGHDAD 3101

Classified By: Economic Counselor Michael Dodman, reasons 1.4(b,d)

¶1. (C) Summary: During an October 13-14 session in London, Oil Minister Husayn al-Shahristani presented terms and conditions for 20-year Technical Service Contracts to develop six oil fields and two gas fields to representatives of the 41 oil and gas companies that had qualified to bid. The contracts will require the companies to make significant up-front investments, with reimbursement and profit to be received only after an up-to-three year "rehabilitation" phase. The level of international oil company interest is uncertain, given Iraq's uncertain investment climate and falling crude oil prices. Actual interest will become clearer based on the number of companies that actually purchase data packages. Another indicator of growing oil company interest in Iraq would be participation in a December 5-7 "Energy Expo and Conference" in Baghdad. End summary.

Former Oil Minister Ghadban's Take

¶2. (U) On October 21, Chairman of the Prime Ministerial Advisory Committee (PMAC) Thamir Ghadban provided background on the October 13-14 meeting to retired FSO and former Ambassador to Tunisia Robin Raphel, visiting Baghdad as part of the Joint Campaign Plan Assessment Team. (Note: Ghadban and Raphel know each other well, from the period when he was Oil Minister, 2004-2005, in the interim government under Iyad Allawi and Raphel was serving as deputy in the Special Inspector General for Iraq Reconstruction, SIGIR.) He noted that the bid round was "structured in the spirit of the (draft) oil law," to be transparent and competitive. Thirty-five companies had pre-qualified, out of 120 that had applied, based on a point system that factored in qualifications such as the companies' financial strength, technical capability and environmental and safety record. (Note: Six more companies were subsequently qualified to bid, ref B.) The roll-out of the bid round took place in London, because that was where the implementing contractor, Gaffney, Cline, and Associates (GCA) was based.

¶3. (SBU) Ghadban said the morning of October 13 began with two sets of presentations -- two MoO officials first presented on legal and contractual issues and then another pair provided technical characteristics of the eight fields available for bid. Although he had attended as a guest, Ghadban said he chaired a question-and-answer session with Shahristani after lunch. The day ended with Shahristani's press conference. The second day, October 14, was devoted to private meetings with 16 companies that had requested them.

¶4. (U) Ghadban said MoO hoped to finalize deals by the end of June, 2009, when it would forward draft contracts to the Council of Ministers (Cabinet) for approval. The companies

would pay to get access to data packages that would also include a draft contract. They would have six months to present their offers, meaning by April, 2009, after which MoO wanted to finalize the proposals in two months. (Note: The timetable seems highly ambitious and likely unrealistic, suggesting that it will slip at least somewhat.) The international oil companies (IOCs) would be expected to form a partnership with the relevant MoO operating company (e.g., South Oil Company, North Oil Company) after which the workers on the field in question would be absorbed into the joint venture (JV). The MoO operating company would have 51% of the joint venture and the IOC, 49%, but the MoO operating company would pay for its share of the assets, Ghadban emphasized. (Note: This approach is familiar, since it is the same approach in a Shell deal with South Gas Company to collect and market flared gas, ref C.)

¶5. (U) Ghadban commented that there were two variables that the IOCs could adjust to make their bids as competitive as possible. First was the amount of additional production that the IOC committed to reach. Second, although all companies would recover their costs, the IOC would need to set the revenue per barrel that it would receive, its "profit." The payment could be either in cash or oil, Ghadban noted. He said profitability was contained in an "R ratio," the total revenue divided by the total cost. He claimed the IOC could book the field's reserves, since it could establish its total revenue based on the payment per barrel multiplied by the total barrels expected to be lifted over the 20-year term of the contract.

¶6. (U) Ghadban briefly discussed the difference between a

Production Sharing Agreement (PSA), which was a common contractual arrangement for developing oil and gas fields, and the Technical Service Agreements (TSA) offered in London. He said a PSA more definitely transferred custody of the field. A PSA generally had a longer duration, but the 20-year term of Iraq's TSAs was similar to PSAs. Second, the PSA designated the IOC as the field's "operator." In Iraq, on the other hand, the IOC would be a "co-operator" of the field with an Iraqi entity. Exactly what this status meant, Ghadban later commented, was still unclear. In addition, the PSA provided safeguards for the IOC, protecting the investor from changes in taxation regimes or law, with appropriate compensation required for losses from legal or regulatory changes. Finally, Ghadban added that, even under PSAs, the country granting the PSA still owned the oil or gas until the point it was loaded onto a foreign carrier.

¶7. (C) Ghadban said the current bid round was for large fields that were producing. MoO was planning to hold a second bid round before the end of 2008 for fields that had been discovered, but not producing. (Note: An MoO official later told us that 15 fields would be included in this round.) A third bid round, for early in 2009, would invite bids on another group of smaller fields. There would also be a separate round to explore for undiscovered fields. Ghadban commented that there were elements within MoO opposed to issuing contracts for producing fields, arguing that Iraq had the capacity to increase production from such fields on its own. This faction preferred that the IOCs only be invited to develop fields that were not yet producing.

Bidding Qualifications

¶8. (U) Media reports, including an October 14 Oil Daily story, add details that Ghadban did not mention. Despite the fact that all companies had "pre-qualified," only the companies producing more than 500,000 barrels per day (bbl/d) can bid on a contract for the super-giant Rumaila and Kirkuk fields; companies producing 250,000-500,000 bbl/d can bid for contracts on the other fields, while companies with less than 250,000 bbl/d can only participate as junior partners in a

consortium. Consortia, however, will be limited to three bids only. A fourth category will comprise companies qualified as gas operators.

Timeline

¶9. (U) The media reporting also noted that the IOCs would be held to a strict timeline, with signing of a final agreement within three weeks of contract award, and all winning bidders would be required to open offices in Iraq within 90 days of the effective contract date. Although exactly when companies would be reimbursed for costs incurred is not clear, MoO Petroleum Contracts and Licensing Director General Natik al-Bayati told Oil Daily that service fee payments would not begin until incremental production comes on line, which is expected to be within 24 months of the effective contract date or once incremental production is 10% above baseline production.

¶10. (C) In addition, we had an informal read-out from an official from an international organization (IO), the only non-GOI person attending who was not a representative of a qualified company. She reported that the TSCs would either be Production Field Technical Service Contracts (PFTSC) for the six core oil fields currently managed by North Oil Company, South Oil Company, and Maysan Oil Company, and Gas Service Development and Production Contracts (GSDPC) for the green field gas reservoirs. For the PFTSC, the contractor will be required to develop a rehabilitation phase within six months of the contract date, and then will have a 60-day period to begin preparations before starting the actual rehabilitation. The rehabilitation phase will end after 24 months or whenever production exceeds baseline production by 10% for 30 consecutive days. The media reported that, in the first phase, companies would be expected to conduct 3D seismic exploration, well work-overs, and rehabilitation of surface facilities. The work must start within six months of the signing date, or the contract would be annulled, and companies cannot claim poor security conditions as a reason for delay.

Fees and Reimbursement

¶11. (C) Additional media reporting said that the bids would consist of a per barrel fee for maintaining current production, another per barrel fee for increased production,

and a target production goal for the field. Our IO contact said the non-reimbursable signature bonus that the winning bidder would be required to pay would consist of $10 million plus $50 for each barrel by which baseline production exceeds 100,000 barrels per day. (Thus, in the case of North Rumaila, for example, which we understand currently produces 500,000 bbl/d, the signing bonus would end up being $30 million.)

¶12. (C) The IO contact added that the service fee would consist of petroleum costs accrued from the effective date of the contract, to be fully reimbursed but only paid at the end of the rehabilitation phase (i.e., a maximum period of three years) and a "remuneration fee." The remuneration fee would also have two components: a flat fee per barrel for maintaining production, which would be part of the bid package, and an incremental remuneration fee, with a maximum per barrel, again to be proposed by the bidder as part of the bid package. The service fees would be payable quarterly, in cash or in kind consisting of crude oil liftings at designated export points (Al-Basra Oil Terminal, Khor al-Amaya Oil Terminal, or Ceyhan). Access to data packages would also require fee payment, $500,000 for the oil fields, with the exception of $350,000 for Maysan, and $250,000 for each of the two gas fields. Access to all data packages would cost $2.5 million.

Industry Reaction

¶13. (C) Our IO source said that, during the question-and-answer session, the audience of around 200 IOC representatives reacted skeptically to MoO's claims regarding the generosity of its offer and negatively to the high value of the signature bonus. Questions were directed to the ambiguities created by MoO's attempts to maintain consistency with the draft hydrocarbons law, including the rationale for Council of Ministers' approval of contracts and what role the provincial governments would play in oil field operation. The company representatives were uneasy regarding the risk of political interference introduced with the Council of Ministers' role.

¶14. (C) The IO source said another questioner sought clarification of roles and responsibilities arising from the "co-operation" of the fields. MoO's explanation followed up on its earlier presentation that an MoO Regional Oil Company (ROC) would form the JV with the international investor. The ROC and foreign partner would both nominate four members to a Joint Management Committee (JMC) to manage operations, with the ROC holding the chairmanship and the foreign partner filling the deputy chair and secretary positions. Unanimous JMC approval would be required to adopt decisions. During the Q-and-A session, MoO clarified that the JMC would establish a Joint Operating Agreement to specify respective obligations and rights.

¶15. (C) There was some confusion regarding the tax rate. While oil field investors would not be eligible for a tax holiday, during the meeting, Ghadban disputed MoO's response that the tax would be 35%. He said the marginal corporate tax rate now is 15% and only the Iraqi Parliament could change it. The audience was also skeptical about dispute settlement mechanisms. In general, according to our IO source, the potential investors seemed to have attended out of curiosity, rather than a definite decision to proceed with a bid. They were uncertain about whether to invest now in Iraq, due to the continuing political uncertainty, poor security, and unclear, unrevised commercial legislation.

Not a Level Playing Field

¶16. (C) MoO Legal Directorate Director General Laith told DOE Energy attache later that investors also had some concerns regarding an advantage that the IOCs that had been negotiating short-term TSCs might have. The IOCs (Exxon, Chevron, BP, Shell, and Total) have already carried out no-fee studies of certain fields, so would have an advantage in preparing a bid package. Laith was concerned that other companies would decide not to compete against them, if they had such a competitive lead. (On the other hand, we heard through other channels that at least some of the companies were complaining about having to buy back the data packages that they themselves had prepared.) We also heard indirectly that the IOCs were concerned regarding how MoO would be calculating baseline production, which would critically influence profitability of operations. They complained that the figures were soft, due to a lack of metering to substantiate production, and so were subject to inflation.

Comment:

¶17. (C) At first blush, the MoO seems to be squeezing the potential international investor partners too stringently with its proffered terms. On the one hand, opportunities to add production are limited, but, on the other hand, the price of oil is dropping along with what promises to be an extended economic downturn, suggesting that oil companies will be

cautious about expenditures that do not add immediately to the bottom line. The previously cited uncertainties regarding investing in Iraq also remain. Bids from all 41 companies would be surprising, under these circumstances. (We already know that three companies have been discouraged from bidding and quietly offered side deals on another field, ref A.) At a minimum, a likely scenario is that the oil majors who were negotiating previously for short-term TSCs will form consortia with the smaller, hungrier oil companies, especially since MoO stated that it would give preference to consortium bidders, and submit bids. This approach will reduce costs and s
pread risk.

¶18. (SBU) The first indicator of IOC interest will be the number of companies that actually pay for data packages, which will be available by October 31. We could also see attendance and participation at a December 5-7 "Iraq Energy Expo and Conference" in Baghdad to be another indicator of how actively IOCs are pursuing their bids. The participation in the MoO-supported trade show would be an opportunity to curry favor. Despite the organizer's inflated claims, we had doubted whether major petroleum companies would actually participate. On the trade show's website most recently, however, Crescent Petroleum is listed as a Diamond Sponsor and among the Platinum Sponsors are ConocoPhillips, Lukoil, Gazprom, and Korea's SK Energy. Japan's Inpex and Eneos Nippon Oil and Kogas (Korea Gas) are Gold Sponsors, while Spain's Repsol, Marathon, and Premier Oil are Bronze Sponsors. End comment.
CROCKER